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JAPAN-MIDDLE EAST RELATIONS ENTERING A NEW ERA?

Summary

While Japan continues to depend on the Middle East for about 70 percent of its crude oil needs, the end of both the Iran-Iraq war and the Iraqi occupation of Kuwait have wrought changes in Japanese and Middle Eastern views of bilateral economic and political relations. On the economic side oil will remain the bedrock of bilateral trade but exchanges of other goods and services are becoming more prominent, as are investment and aid. In step with Tokyo's desire to play a role in international affairs commensurate with its economic strength, Japanese foreign policy toward the region is in a period of reassessment and change.

Background

Until the early 1970s Japan's relations with the Middle East could best be described as "detached." Political and cultural ties were weak, and even economic contacts -- mainly in the form of Japanese purchases of crude oil -- were indirect, as Japanese oil companies preferred to contract for deliveries with foreign oil companies rather than establish their own presence in the Persian Gulf. This detachment insulated Japan from much of the historical enmity and political tension that plagues American or European relations with the region. Moreover, Japan's renouncement of the use of external military force and its policy of maintaining evenhanded diplomatic ties to most nations in the region gave Japan a neutral cast in affairs there.

The 1973 Arab-Israeli War and the threat by the newly formed Organization of Petroleum Exporting Countries to cut off oil supplies motivated Tokyo to abandon its bystander position. Maintaining access to Mideast oil rapidly

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shifted from an implicit to an explicit tenet in Tokyo's policy toward the region. Japanese government officials began calling regularly on Middle Eastern counterparts, and Japanese firms began dealing directly with companies and governments of the region.

For the remainder of the 1970s and throughout the 1980s the goal of maintaining friendly relations with oil producers, and thus access to oil, generally was second only to good relations with the United States on Japan's foreign policy agenda. These two priorities often were in harmony. For example, both Washington and Tokyo put a premium on the unrestricted transport of oil in and out of the Persian Gulf. This meant that the two allies cooperated on discouraging regional conflicts and curtailing the Soviet Union's influence in the gulf. On several occasions, however, Tokyo's need for oil put it at odds with Washington, most notably in relation to Iran and the Arab-Israeli conflict. Nevertheless, Tokyo emerged from the 1980s having pursued with general success a balancing act between its top foreign policy goals, generally following but at times defying U.S. policy in the region (see JEI Report No. 9A, March 4, 1988).

The 1990s, however, have brought even greater demands on Tokyo -- calls from within and without for Japan to bear international responsibilities equal to its economic strength, which had grown tremendously over the previous decade. Beyond expanded foreign aid, this new burden includes more independent, actively involved policies in foreign affairs and trade that promote higher goals than profits for Japanese businessmen or Japan's economic survival. Tokyo's new list of policy goals goes beyond its traditional aims of facilitating economic development and resolving disputes nonviolently to include cleaning up the environment, reducing the global arms race and fostering political democratization. Iraq's August 1990 invasion of Kuwait, the subsequent multinational military campaign to free Kuwait and the creation of a stable postconflict political and economic order in the Middle East have served as a crucible to test Japan's newly proclaimed mettle. Today, Japan-Middle East political and economic relations clearly are in a state of flux, complicated by uncertainties arising from post-Cold War adjustments.

Economic Links

In the midst of swirling changes two facets of bilateral trade remain steadfast: Japan's trade deficit with the Middle East and oil's dominant position. Even these two factors, though, are not immutable. Over the past 20 years, for example, the level of economic interdependence has shifted, mostly in Japan's favor, and the pattern of Japan's trade by country and by product has begun to show some interesting developments.

Overall Trade - Japan's trade with the Middle East is linked tightly to the price of crude oil. After expanding rapidly in the 1970s due to sharply higher oil prices, Japan's dollar-denominated two-way trade with the Middle East tapered off in the 1980s as oil prices dropped and the yen strengthened against the dollar (see Table 1). The price relationship still holds, however, as shown by the data for 1989 and 1990. The spike in oil prices caused by

Table 1: Japan's Trade with the Middle East, 1970-90*

(in millions of dollars and percentage of total)

	1970		1975		1980		1985		1989		1990	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Exports												
Food	\$10.3	1.9%	\$68.7	1.2%	\$213.1	1.6%	\$118.1	1.0%	\$35.2	0.4%	\$48.1	0.5%
Raw Materials	3.3	0.6	20.0	0.4	26.1	0.2	47.4	0.4	49.9	0.6	18.1	0.2
Light Industry Products	206.9	37.7	1,043.6	18.6	2,480.3	19.0	2,053.5	18.1	1,487.3	19.0	1,485.8	15.3
Heavy Industry Products	328.3	59.8	4,453.9	79.6	10,312.3	78.8	9,082.6	80.1	6,199.6	79.1	8,074.1	83.3
Chemicals	14.1	2.6	112.5	2.0	256.8	2.0	168.6	1.5	186.6	2.4	283.1	2.9
Metals	118.0	21.5	2,043.6	36.5	2,723.7	20.8	1,775.5	15.7	968.6	12.4	1,061.8	11.0
Nonelectric Machinery	31.0	5.6	652.5	11.7	1,681.2	12.9	2,047.4	18.1	1,263.9	16.1	1,666.6	17.2
Electric Machinery	87.4	15.9	554.3	9.9	2,517.0	19.2	2,191.9	19.3	1,377.2	17.6	1,792.9	18.5
Transportation Equipment	60.7	11.1	974.1	17.4	2,822.5	21.6	2,548.0	22.5	2,086.8	26.6	2,905.2	30.0
Precision Instruments	17.1	3.1	116.9	2.1	311.1	2.4	351.2	3.1	316.6	4.0	364.5	3.8
Other	0.5	0.1	12.5	0.2	51.1	0.4	35.3	0.3	60.8	0.8	66.1	0.7
Total Exports	549.3	100.0	5,598.7	100.0	13,082.8	100.0	11,336.9	100.0	7,833.0	100.0	9,692.0	100.0
Imports												
Food	12.6	0.5	37.1	0.2	45.3	0.1	66.1	0.2	142.2	0.6	154.3	0.5
Raw Materials	60.3	2.7	68.0	0.4	64.2	0.1	103.0	0.4	180.6	0.8	148.7	0.5
Crude Oil	1,860.2	81.8	14,886.9	92.0	38,097.7	86.7	24,243.0	82.6	14,975.6	65.0	22,164.2	70.6
Petroleum Products	241.2	10.6	475.9	2.9	2,288.7	5.2	1,686.9	5.7	4,045.7	17.6	4,607.9	14.7
Liquefied Gas	67.1	2.9	578.5	3.6	3,175.8	7.2	2,781.1	9.5	1,798.8	7.8	2,403.7	7.7
Manufactured Products	30.0	1.3	126.1	0.8	263.0	0.6	434.3	1.5	1,826.9	7.9	1,856.2	5.9
Other	1.3	0.0	5.5	0.0	14.1	0.0	40.1	0.1	59.3	0.3	60.6	0.2
Total Imports	2,273.4	100.0	16,178.0	100.0	43,948.8	100.0	29,354.6	100.0	23,029.1	100.0	31,395.5	100.0
Trade Balance	-1,724.1		-10,579.3		-30,866.0		-18,017.7		-15,196.1		-21,703.5	

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

Iraq's August 1990 invasion of Kuwait boosted the size of Japan's import bill, leading to a sharp reversal of the downward trend in the country's trade deficit with the Middle East.

Just as oil continues to account for the majority of Japan's energy supply, the Middle East remains the principal source of Japanese oil imports (see Table 2). Tokyo has made progress toward cutting its dependence on oil for energy but will find it difficult to reduce this ratio below 50 percent as the nation pursues an improved standard of living. (For a full analysis of Japan's energy situation, see JEI Report No. 23A, June 21, 1991.) Although diversification of oil supplies is a long-standing goal of government and business in Japan, the Middle East with its huge share of global reserves was able to win back some Japanese business in 1989 and 1990, partly because OPEC's difficulty in regulating the production of its members helped keep prices relatively low until the late summer of 1990.

Table 2: Japan's Dependence on Crude Oil and the Middle East, 1970-90

	<u>Crude Oil's Share of Japan's Energy Supply</u>	<u>Middle East's Share of Japan's Oil Imports</u>
1970	70.8%	86.6%
1975	73.3	78.2
1980	65.8	73.3
1985	55.2	69.8
1986	55.2	68.5
1987	56.9	67.5
1988	57.3	67.6
1989	57.5	71.0
1990	54.8	71.5

Sources: Ministry of International Trade and Industry and
Japan Petroleum Association

Oil's impact on trade shows up in other ways. The Middle East's share of Japan's exports and imports exhibits the same price-induced bulge during the 1970s and between 1989 and 1990 as seen above (see Table 3). From the other side of the transaction the price effect is less clear (see Table 4), perhaps because the yen's value strengthened between 1985 and 1988, although Japan's importance as an export market for the Middle East continues. What is visible from both tables, however, is that the relative importance of the other as a trade partner generally has declined. This trend has important political ramifications that are explored below.

Tables 3 and 4 also highlight the basic buyer-seller imbalance between the partners. With relatively small populations but huge natural resources, Middle Eastern nations can absorb a relatively limited proportion of Japan's manufactured exports but can supply a significant share of its input requirements. Resource-poor but industrially strong Japan faces the opposite situation. The bilateral trade imbalance, therefore, naturally tilts in the Middle East's favor.

Table 3: Middle East's* Share of Japan's Trade, 1970-90

(percentage of Japan's exports or imports)

	<u>Exports</u>	<u>Imports</u>
1970	2.8%	12.0%
1975	10.0	28.0
1980	10.1	31.3
1985	6.5	22.7
1986	4.5	14.4
1987	3.7	13.4
1988	3.2	10.4
1989	2.8	10.9
1990	3.4	13.4

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

Table 4: Japan's Share of Middle East's* Trade, 1970-89

(percentage of Middle East's exports or imports)

	<u>Exports</u>	<u>Imports</u>
1970	27.2%	6.9%
1975	20.0	13.2
1980	18.9	13.1
1985	25.5	12.7
1986	19.8	11.8
1987	18.6	10.0
1988	17.1	9.1
1989	17.0	8.3

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

Composition of Trade - Beneath the veneer of oil's domination, the bilateral trade picture reveals several interesting features. After multiple expansions in the 1970s Japanese sales of heavy industrial products to the region have waned more than waxed since 1980 (Table 1). This probably reflects the completion of major infrastructure projects plus the saturation of the small Middle Eastern markets for some important consumer goods, such as televisions and similar electronics products as well as cars. It also may reflect declining

Japanese price competitiveness, particularly between 1985 and 1988 when the value of the yen increased sharply against the dollar and other currencies.

On the import side growing purchases of petroleum products and liquefied natural and/or petroleum gases have accompanied the gradual development of refineries in the Middle East and the liberalization of Japan's energy import policies. Saudi Arabia and Kuwait, in particular, have been pushing into downstream processing to add value to their exports. To accommodate this new capacity Japan and other oil-consuming nations have been cutting domestic refining capacity and have opened their doors to imports of such products as gasoline, jet fuel and kerosene.

On a country basis the sharp demarcation in the volume of Japanese trade between oil producers and nonoil producers is not a surprising phenomenon (see Table 5). Trends within each group also are visible. Among oil producers, for example, Iran and Kuwait played relatively less important roles in Japan's trade in 1990 than 15 years ago, while Saudi Arabia and the United Arab Emirates became more important. Among nonoil-producing countries the variability of trade with some, such as Egypt, is striking. Trade with Israel and Turkey, in contrast, have grown gradually but steadily.

Shifts in the relative importance of Japan's Middle Eastern trading partners come into sharper focus when each nation's trade is analyzed by product (see Tables 6 and 7). The changing fortunes of Iran and Saudi Arabia form the two ends of the spectrum, the former descending from Japan's top regional trading partner as the latter replaced it. Israel's relative decline in the pecking order is not a result of reduced trade; rather, it is a reflection of the trade boom enjoyed by oil-producing Arab countries. As will be discussed below, many Japanese firms generally have followed the Arab-led boycott of Israel, one of the reasons for the relatively low volume of bilateral trade.

Aid - Under a formula adopted in the 1970s Tokyo informally targeted 10 percent of its total official development assistance for the Middle East; this rule continued to guide Japanese foreign aid allocations through the 1980s. As part of its efforts to play a more responsible international role in the 1990s, however, Tokyo has downgraded the geographic formula and is putting greater emphasis on need-based criteria. According to the latest available data, Middle Eastern countries suffered a sharp drop in Japanese ODA disbursements in 1989, falling from \$583 million or 9.1 percent of 1988's total to \$368 million or 5.4 percent (see JEI Report No. 47A, December 14, 1990). The reason for the decline is not apparent. While the oil-producing countries of the region generally do not qualify for aid, the nonoil producers, such as Jordan, Yemen, Syria and Turkey, do. It is not surprising to find that Turkey (which accounted for an average 1.8 percent of total Japanese ODA in the 1987-88 period), Egypt (1.6 percent) and Syria (0.9 percent) account for the majority of Japan's Middle East aid.

The Persian Gulf conflict presented Tokyo with an opportunity to demonstrate its commitment to humanitarian and environmental issues. Since Iraq invaded Kuwait last August, Tokyo has pledged a total of \$142.5 million to international relief organizations working in the Middle East, including the United Nations Disaster Relief Coordination Office, the International Committee of the Red Cross and the International Organization for Migration (see JEI Report No. 26A, July 12, 1991). Last month Japan also said that a portion of the

Table 5: Japan's Trade With Selected Middle Eastern Countries, 1970-90

(in millions of dollars and percentage of total trade with Middle East*)

	1970		1975		1980		1985		1989		1990	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Iran												
Exports	\$178.7	27.5%	\$1,854.3	29.9%	\$1,529.5	10.5%	\$1,347.7	10.7%	\$922.4	10.3%	\$1,617.2	14.9%
Imports	995.3	42.1	4,977.8	30.1	4,101.0	9.2	2,505.8	8.4	1,792.3	7.7	3,460.1	10.9
Iraq												
Exports	15.9	2.4	818.8	13.2	2,169.5	14.9	1,305.6	10.4	490.7	5.5	251.4	2.3
Imports	0.2	0.1	395.9	2.4	4,339.1	9.7	621.5	2.1	1,214.5	5.2	910.9	2.9
Saudi Arabia												
Exports	83.8	12.9	1,350.8	21.7	4,855.7	33.4	3,890.0	30.9	2,763.2	30.9	3,341.2	30.7
Import	435.1	18.4	6,135.1	37.1	19,538.1	43.9	10,244.7	34.2	7,048.3	30.3	10,461.6	33.1
Kuwait												
Exports	94.4	14.5	367.2	5.9	1,272.9	8.7	1,536.1	12.2	670.8	7.5	397.9	3.7
Imports	308.3	13.0	2,011.7	12.2	3,457.6	7.8	1,162.3	3.9	2,338.9	10.0	1,711.4	5.4
United Arab Emirates												
Exports	0.0	0.0	420.2	6.8	1,355.9	9.3	1,164.4	9.2	1,296.2	14.5	1,550.3	14.3
Imports	0.0	0.0	1,774.0	10.7	8,190.4	18.4	8,916.3	29.7	6,051.4	26.0	9,084.6	28.7
Jordan												
Exports	11.0	1.7	67.6	1.1	193.7	1.3	190.1	1.5	66.6	0.7	61.8	0.6
Imports	0.1	0.0	11.8	0.1	21.7	0.1	28.1	0.1	23.5	0.1	27.4	0.1
Syria												
Exports	16.1	2.5	108.2	1.7	198.4	1.4	126.9	1.0	76.2	0.9	69.6	0.6
Imports	16.7	0.7	3.3	0.0	2.8	0.0	3.1	0.0	4.3	0.0	4.7	0.0
Egypt												
Exports	12.4	1.9	212.4	3.4	644.3	4.4	730.9	5.8	472.0	5.3	525.5	4.8
Imports	47.3	2.0	12.4	0.1	141.8	0.3	544.5	1.8	118.9	0.5	119.3	0.4
Israel												
Exports	20.0	3.1	73.2	1.2	108.6	0.7	170.4	1.4	317.5	3.6	509.0	4.7
Imports	27.8	1.2	89.4	0.5	227.0	0.5	214.9	0.7	757.9	3.3	879.4	2.8
Turkey												
Exports	13.4	2.1	39.6	0.6	194.6	1.3	433.6	3.4	377.3	4.2	991.6	9.1
Imports	28.4	1.2	42.3	0.3	39.4	0.1	60.5	0.2	238.1	1.0	267.3	0.8

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq, Iran, Egypt, Gaza, Cyprus, Libya, Sudan, Ethiopia, Djibouti and Somalia.

Source: Ministry of Finance

Table 6: Japan's Exports to Selected Middle Eastern Countries by Product Group, 1970-90

(in millions of dollars and percentage of exports to Middle East*)

	1970		1975		1980		1985		1989		1990	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
<u>Light Manufactures</u>												
Iran	\$45.8	26.9%	\$287.1	27.5%	\$365.5	14.7%	\$264.8	12.9%	\$161.9	10.9%	\$242.0	16.3%
Iraq	4.2	2.0	80.4	7.7	275.2	11.1	207.1	10.1	147.0	9.9	29.8	2.0
Saudi Arabia	39.8	19.3	265.2	25.4	840.6	33.9	731.4	35.6	489.6	32.9	534.3	36.0
Kuwait	29.6	14.3	112.9	10.8	331.5	13.4	199.9	9.7	117.5	7.9	76.7	5.2
United Arab Emirates**	26.4	12.7	111.7	10.7	313.8	12.7	346.0	16.7	349.0	23.5	326.8	22.0
Israel	4.9	2.4	8.3	0.8	13.4	0.5	25.4	1.2	27.7	1.9	32.6	2.2
Turkey	2.1	1.0	9.1	0.9	4.1	0.2	28.4	1.4	43.1	2.9	89.5	6.0
<u>Chemicals</u>												
Iran	5.1	36.1	59.6	53.0	111.8	43.5	47.3	28.0	42.9	23.0	129.9	45.9
Iraq	1.5	10.8	14.8	13.2	41.6	16.2	23.1	13.7	18.0	9.6	7.3	2.6
Saudi Arabia	1.1	8.3	10.7	9.6	28.6	11.1	38.1	22.6	49.3	26.4	51.3	18.1
Kuwait	1.2	8.1	4.5	4.0	17.2	6.7	13.3	7.9	9.9	5.3	10.5	3.7
United Arab Emirates**	0.5	3.8	3.0	2.6	16.3	6.4	13.3	7.9	13.4	7.2	20.8	7.4
Israel	1.8	13.0	7.0	7.4	12.9	5.0	9.3	5.5	16.5	8.9	22.6	8.0
Turkey	0.7	5.0	5.4	4.8	10.0	3.9	7.9	4.7	21.2	11.4	23.3	8.2
<u>Metals</u>												
Iran	63.1	54.2	866.9	42.4	511.1	18.8	392.6	22.1	192.1	19.8	384.7	36.2
Iraq	5.2	4.4	398.7	19.5	515.8	18.9	196.4	11.1	74.6	7.7	59.5	5.6
Saudi Arabia	11.5	9.8	378.6	18.5	978.2	35.9	583.9	32.9	334.4	34.5	282.4	26.6
Kuwait	6.9	5.8	67.7	3.3	188.9	6.9	205.5	11.6	83.6	8.6	46.3	4.4
United Arab Emirates**	8.9	7.6	111.2	5.4	256.6	9.4	143.2	8.1	85.2	8.8	122.4	11.5
Israel	3.5	3.0	27.1	1.3	13.3	0.5	9.5	0.5	9.5	1.0	11.3	1.1
Turkey	5.3	4.5	60.4	3.0	41.0	1.5	27.5	1.5	20.9	2.2	47.3	4.5
<u>Nonelectric Machinery</u>												
Iran	11.2	36.3	222.7	34.1	137.7	8.2	169.8	8.3	241.8	19.1	418.8	25.1
Iraq	1.2	3.7	134.1	20.5	430.9	25.6	357.8	17.5	102.6	8.1	56.4	3.4
Saudi Arabia	3.3	10.6	151.2	23.2	533.9	31.8	505.1	24.7	314.4	24.9	445.2	26.7
Kuwait	4.5	14.4	28.6	4.4	130.9	7.8	421.6	20.6	104.4	8.3	75.0	4.5
United Arab Emirates**	1.3	4.1	24.6	3.8	161.9	9.6	153.0	7.5	167.7	13.3	204.6	12.3
Israel	1.9	6.1	5.8	0.9	9.4	0.6	40.3	2.0	43.0	3.4	58.1	3.5
Turkey	3.5	11.3	31.3	4.8	104.2	6.2	137.0	6.7	116.6	9.2	263.0	15.8
<u>Electric Machinery</u>												
Iran	27.1	31.0	148.7	26.8	224.1	8.9	187.6	8.6	105.8	7.7	283.3	13.3
Iraq	2.4	2.7	53.7	9.7	345.6	13.7	146.0	6.7	80.3	5.8	40.5	2.3
Saudi Arabia	7.4	8.4	128.8	23.2	915.6	36.4	777.5	35.5	460.7	33.4	574.6	32.1
Kuwait	25.1	28.7	72.8	13.1	348.9	13.9	445.4	20.3	100.6	7.3	55.0	3.1
United Arab Emirates**	7.0	8.0	56.0	10.1	307.7	12.2	200.3	9.1	294.8	21.4	405.6	22.6
Israel	3.1	3.5	9.8	1.8	25.6	1.0	34.9	1.6	70.1	5.1	104.5	5.8
Turkey	2.9	3.3	21.6	3.9	27.9	1.1	147.9	6.7	128.0	9.3	234.5	13.1
<u>Transportation Equipment</u>												
Iran	11.1	18.3	226.9	23.3	126.7	4.5	213.8	8.4	108.7	5.2	133.0	4.6
Iraq	1.2	2.0	121.6	12.5	520.3	18.4	327.7	12.9	48.0	2.3	47.0	1.6
Saudi Arabia	14.8	24.3	356.9	36.6	1,246.1	44.1	1,044.4	41.0	980.3	47.0	1,318.1	45.4
Kuwait	23.8	39.2	62.9	6.5	213.4	7.6	197.5	7.8	220.5	10.6	114.6	3.9
United Arab Emirates**	4.7	7.7	92.7	9.5	244.7	8.7	240.1	9.4	297.4	14.3	364.2	12.5
Israel	0.4	0.7	2.0	0.2	17.6	0.6	26.2	1.0	106.9	5.1	217.2	7.5
Turkey	0.5	0.8	2.9	0.3	2.0	0.1	75.0	2.9	33.3	1.6	300.4	10.3

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.

**Figures for 1970 include Bahrain and Qatar.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

Table 7: Japan's Imports from Selected Middle Eastern Countries by Product Group, 1970-90

(in millions of dollars and percentage of imports from Middle East*)

	1970		1975		1980		1985		1989		1990	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Food												
Iran	\$4.9	39.3%	\$7.4	20.0%	\$5.8	12.8%	\$3.6	5.4%	\$30.2	21.2%	\$26.5	17.2%
Iraq	0.1	0.9	0.3	0.9	0.5	1.0	2.1	3.1	0.0	0.0	0.0	0.0
Saudi Arabia	0.3	2.7	0.1	0.3	0.0	0.0	1.0	0.1	0.0	0.0	0.0	0.0
Kuwait	0.5	3.9	1.2	3.1	1.6	3.5	3.6	5.5	9.2	6.5	3.9	2.5
United Arab Emirates**	1.8	14.0	0.0	0.0	0.0	0.0	9.7	14.7	3.6	2.5	0.7	0.4
Israel	0.0	0.0	5.7	15.3	6.7	14.8	14.8	22.5	19.5	13.7	34.8	24.5
Turkey	4.0	32.2	13.3	35.9	12.4	27.3	26.3	39.8	58.6	41.2	79.0	51.2
Raw Materials												
Iran	13.2	21.9	16.5	24.3	6.5	10.1	3.0	2.9	16.1	8.9	8.4	5.7
Iraq	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Saudi Arabia	0.1	0.1	0.0	0.0	0.2	0.2	27.7	26.9	51.2	28.3	44.0	29.6
Kuwait	1.6	2.6	0.7	1.0	3.6	5.5	9.3	9.0	9.8	9.0	3.9	3.7
United Arab Emirates**	0.1	0.1	0.0	0.0	0.8	1.3	0.0	0.0	14.2	7.9	13.9	9.4
Israel	1.1	1.8	3.4	4.9	1.6	2.5	1.5	1.5	0.0	0.0	0.0	0.0
Turkey	21.2	35.1	28.0	35.1	26.2	40.9	23.0	22.4	53.6	31.3	43.5	29.2
Crude Oil												
Iran	932.7	52.5	4,793.0	52.5	3,566.0	9.4	2,480.6	10.2	1,689.4	11.3	3,365.4	15.2
Iraq	0.0	0.0	0.0	0.0	4,277.6	11.2	616.4	2.5	1,199.3	8.0	894.8	4.0
Saudi Arabia	331.8	17.8	5,680.6	38.2	17,207.2	45.2	8,102.9	33.4	3,378.3	25.0	6,328.8	28.6
Kuwait	192.7	10.4	1,719.4	11.5	2,104.8	5.5	559.3	2.3	985.7	6.6	817.2	0.2
United Arab Emirates**	117.4	6.3	1,733.8	11.9	7,419.0	19.5	7,379.0	30.4	4,413.4	29.5	6,875.1	31.0
Israel	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Turkey	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Petroleum Products												
Iran	35.6	14.7	52.4	11.0	46.6	21.7	13.8	0.8	0.0	0.0	0.0	0.0
Iraq	0.0	0.0	6.7	1.4	58.4	2.6	0.0	0.0	8.7	0.2	15.1	0.3
Saudi Arabia	71.8	29.8	93.4	19.6	563.7	24.6	653.8	38.8	2,058.4	50.9	2,615.1	56.8
Kuwait	85.0	35.2	184.8	38.8	743.3	32.5	397.6	23.6	1,055.1	26.1	687.3	14.9
United Arab Emirates**	23.5	9.7	0.0	0.0	0.0	0.0	0.0	0.0	487.5	12.0	783.5	16.0
Israel	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Turkey	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liquefied Natural/Petroleum Gas												
Iran	0.0	0.0	98.6	17.0	23.1	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Iraq	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Saudi Arabia	31.0	52.2	360.3	62.3	1,763.4	55.5	1,324.0	47.6	768.2	42.7	1,159.2	48.2
Kuwait	28.3	47.8	105.6	18.3	602.2	19.0	187.9	6.8	206.9	11.5	147.3	0.2
United Arab Emirates**	0.0	0.0	0.0	0.0	746.4	19.5	1,155.3	41.5	753.2	41.9	1,011.1	42.1
Israel	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Turkey	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufactured Products												
Iran	0.0	0.0	0.0	0.0	2.1	0.8	4.5	1.0	50.4	2.8	55.4	3.0
Iraq	0.0	0.0	0.1	0.1	0.8	0.3	0.2	0.0	0.0	0.0	0.0	0.0
Saudi Arabia	0.0	0.0	0.0	0.0	0.1	0.0	117.7	27.1	406.6	22.3	271.8	14.6
Kuwait	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.1	70.2	3.8	47.6	2.6
United Arab Emirates**	0.0	0.0	0.0	0.0	4.6	1.8	52.6	12.1	356.2	19.5	390.9	21.1
Israel	26.7	89.1	80.2	63.6	218.6	83.1	197.6	45.5	729.6	39.9	838.1	45.2
Turkey	2.9	6.8	0.4	6.8	0.7	0.3	4.2	1.0	124.8	6.8	144.3	7.8

*Middle East includes: Turkey, Syria, Lebanon, Israel, Jordan, Saudi Arabia, Yemen, Oman, United Arab Emirates, Qatar, Bahrain, Kuwait, Iraq and Iran.

**Figures for 1970 include Bahrain and Qatar.

Source: Ministry of International Trade and Industry, White Paper on Trade and Industry, various years.

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approximately \$500 million it provided for additional peacekeeping efforts in the region would go for humanitarian aid (see JEI Report No. 27B, July 19, 1991). Another \$1.1 million went to buy supplies for refugees streaming out of Kuwait and Iraq into Jordan. Some of Japan's contributions helped pay to fly approximately 1,800 of these refugees back to their home countries. Government and business also provided vehicles and housing materials worth an undisclosed amount to Iran to support refugee relief efforts there.

Although it took time to organize, Tokyo has given a total of \$2.6 million to help clean up the oil spills and oil well fires resulting from the Persian Gulf War. A total of \$1.5 million has gone to the International Maritime Organization to fight oil spills, including containment booms, absorbents and skimming equipment. The remaining \$1.1 million is earmarked for a trust fund managed by the United Nations Environment Program to alleviate the long-term effects of the spills and the fires.

Tokyo made aid part of its direct response to the gulf conflict, another step in the evolution of its policy of using aid for strategic purposes. A total of \$2 billion was pledged for the frontline states of Jordan, Egypt and Turkey to help them cope with economic losses incurred because of the multinational trade embargo against Iraq and Iraqi-occupied Kuwait. Turkey and Jordan received \$700 million each, while Egypt received the remaining \$600 million. The majority of funds took the form of loans for emergency purchases of commodities or to finance trade in vital items and to support specific projects, such as constructing factories.

As the economic impact of the conflict lingers, more Japanese foreign aid is likely to be channeled toward the Middle East. A \$100 million commitment to Syria already has been inked, and further aid is expected to be forthcoming for Jordan and other low-income countries of the region. Reconstruction aid to Iraq is almost certain once Baghdad has met all United Nations' peace conditions; that money probably will go through multilateral organizations to avoid political frictions with Western allies. What is not yet clear is whether Tokyo will help with the reconstruction of Kuwait. Tokyo might find it difficult to provide aid to a country that boasted a per capita income of over \$20,000 before the war and still has vast assets to tap. The devastation of Kuwait is unquestioned, however, and Kuwaiti officials have hinted that they will seek funds from all sources, including Japan. (This issue is explored more fully below.)

Investment - The Middle East traditionally has not been the focus of Japanese private foreign direct investment activity. The region, in fact, accounted for a mere 1.1 percent of total foreign direct investment as of March 1991 (see Table 8). This, in part, is a consequence of Japan's detached economic relations with the region; it also reflects regional tensions and conflicts, which drive up the risks for investors, Japanese or otherwise. Although the oil-rich countries do not need foreign direct investment since their oil revenues can cover domestic investment needs, nonoil-producing nations would like more Japanese investment; generally, however, they cannot attract it because they lack natural resources to develop, their domestic markets are small and their industrial and agricultural potentials are limited.

Some governments among the nonoil producers are trying to change this. Egypt, for example, has initiated a system of free trade zones to capitalize on

Table 8: Japan's Foreign Direct Investment in the Middle East,
FY 1989-FY 1990

(in number of cases, millions of dollars and percent)

	FY 1988			FY 1990			Cumulative March 31, 1991		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
Kuwait	--	\$32	--%	--	\$26	--%	4	\$1,441	0.5%
Iran	--	1	--	0	0	0.0	108	1,006	0.3
United Arab Emirates	2	6	--	0	0	0.0	47	441	0.1
Saudi Arabia	0	0	0.0	0	0	0.0	101	369	0.1
Bahrain	1	24	--	0	0	0.0	23	128	--
Other	2	3	--	1	1	--	57	45	--
Total	5	66	0.1	1	27	--	340	3,431	1.1

Source: Ministry of Finance

its abundant, inexpensive labor supply. Cairo also is privatizing state-owned enterprises and other government-run projects; over the next five years 71 state-owned companies will be put on the auction block, as will about 4,000 local operations. Six Japanese manufacturers and two financial firms presently have a toehold in the Egyptian market.

A joint venture between Suzuki Motor Co., Ltd. and an Egyptian conglomerate illustrates the problems facing foreign investors. Production of light delivery vehicles at Suzuki Egypt S.A.E. has grown steadily since the venture was launched in 1988, four years after the government barred imports of foreign vehicles. The joint venture suffers, however, from foreign exchange controls, high prices for imported parts, a devalued local currency (which amplifies import price hikes), weak regional exports and controls on domestic markets and prices. Cairo has some concerns, too, primarily because a network of local parts suppliers has not developed even though the final assembly plant has been in operation several years; the domestic content of the vehicles remains well under 50 percent. Not only are investments in capital and human resources necessary, but regulatory and structural changes also are needed before Japanese investors will view nonoil-producing countries as more hospitable investment environments.

Japan-Middle East economic links clearly have deepened and become more varied. Oil remains the main *raison d'être* for commercial ties, but economic relations have a great deal of room for expansion and development. Greater Japanese investment and aid will be key determinants of the shape of future trade relations. Increasingly, though, Japanese foreign policy toward the region will have a stronger hand in shaping economic ties.

Foreign Relations

Tokyo's Middle East policy, having evolved from one of detachment to one that generally reflected trade concerns or the U.S. line, now is in the midst of another transformation. Tired of the "economic giant, political pygmy" label

but cognizant of its limited leverage in the region, Tokyo has begun searching for fields where it can play a more active, or even a leadership, role. Just as the inhospitable desert has tested men for centuries, Tokyo is finding the Middle East to be a harsh testing ground for new foreign policy initiatives.

Persian Gulf War - Although hardly alone in the international community at being caught off guard by Iraq's invasion of Kuwait, Tokyo also was at a loss when the United States exercised its military option almost as quickly as it pursued other, diplomatic alternatives, including economic sanctions. While Tokyo's actions during the Persian Gulf crisis and the war's general impact on Japanese foreign policy revealed a certain amount of policy ferment (see JEI Report No. 6A, February 15, 1991), these still occurred against a background of limitations imposed by Japan's "peace constitution" (see JEI Report No. 13A, April 5, 1991). Perhaps more revealing about Japan's attitudes toward the Middle East are the actions taken after the fighting ended and the process of building a new and stable order in the gulf had begun.

- Postconflict Cleanup - Prime Minister Toshiki Kaifu's late April decision to send Maritime Self-Defense Force minesweepers to the Persian Gulf was controversial among politicians and academicians but much less so among the general population (see JEI Report No. 17B, May 3, 1991). The dispatch of MSDF vessels well beyond coastal areas was an unprecedented act in Japan's postwar history. Mr. Kaifu's argument that the clearing of mines from Persian Gulf waters was a legitimate and peaceful act of self-defense stretched the definition of that term to new lengths, setting an important precedent. Although Mr. Kaifu cited a pledge to Western allies as another reason for the mission, domestic analysts credit intense pressure from the business community, which was worried about safe passage through the gulf for shipping, as a key factor in the politically dicey decision.

Japan's contribution to cleaning up the environmental detritus of the gulf conflict provides other insights into Japan's foreign policy. Tokyo initially targeted this area as one way Japan could contribute significantly to the multinational Persian Gulf task force. While the conflict raged, however, the government found it difficult to follow up, mainly because the equipment and personnel available to fight oil spills and oil fires are under private control. No amount of badgering by Tokyo could convince these private-sector specialists to risk a trip to the gulf while bullets and missiles were flying, although the government did send some oil booms and other equipment (see JEI Report No. 5B, February 8, 1991). Once the fighting was over, cooperation was more forthcoming as Tokyo began sending teams to assess the work necessary for offsetting the massive environmental damage. Further commitments of equipment and workers followed.

Even then, however, Tokyo cannot claim a leading role in this area. Although its contribution is on par with that of France and Germany, for example, American experts in oil fires have led the effort to extinguish the hundreds of Kuwaiti oil wells set ablaze by retreating Iraqis. The Japanese contribution was and is significant but not equal to its potential in the eyes of some domestic and foreign observers.

- Gulf Reconstruction - With a big foreign aid budget, ample private-sector funds and a world-class construction and engineering industry, Japan seems ideally suited to take up the task of rebuilding war-torn gulf economies.

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Institutional and political obstacles, however, likely will limit Japan's role in this area to a supporting one.

As mentioned above, Kuwait's high per capita income level disqualifies it for official development assistance under existing Japanese guidelines. Nevertheless, Tokyo is looking into extending Export-Import Bank of Japan loans and encouraging private bank lending to assist Kuwait's rebuilding. Direct participation by Japanese contractors, however, faces political hurdles arising from Tokyo's hesitant response and limited nonmilitary participation in the gulf crisis. Kuwaiti officials directing the rebuilding thanked their liberators by giving most of the initial contracts to American and European firms (see JEI Report No. 9B, March 8, 1991). As the work proceeds, however, the Kuwaitis are expected to reduce the input of such political considerations and give heavier weight to economic factors. If this is the case, Japanese firms may have an advantage on some contracts, either because they were the original builders of a plant or facility or because they can offer better technology, contract terms or service. In any case, original estimates of the cost of reconstruction are proving to be highly optimistic and Kuwaiti reconstruction may not be the predicted "mother of all projects."

Regional Arms Control - With its peace constitution credentials, Tokyo sees a natural role for Japan in restraining arms races among small countries. Tokyo's willingness to use the promise of greater foreign aid as a carrot and less aid as a stick to encourage military spending cuts by developing countries is a notable new feature of Japan's foreign policy. Unfortunately, this carrot appears unappetizing to Arab states that generally can afford sizable defense budgets; the stick is equally unimpressive given the comparatively small amounts of Japanese aid flowing to the region. In July Prime Minister Kaifu approached the problem from another angle at the London summit of leaders from the world's major industrial democracies. He proposed to establish an arms trade register. Although Great Britain is working with Japan on this approach, its effectiveness at discouraging the arms trade is uncertain.

Overall, it is clear that Tokyo is trying to find ways to be a more active participant in the Middle East's efforts to find a stable postconflict order. Unfortunately, Tokyo's foreign policy toolbox seems to contain only ineffective implements. Because of its limited stature in the region, some analysts say Tokyo's most appropriate role may be to fall in line behind the United States with its checkbook at the ready.

Israeli-Arab Conflict - Given Japan's desire to remain on friendly terms with Middle East oil suppliers and America's staunch support for Israel, it is not surprising that Tokyo often has found itself between a rock and a hard place when dealing with Israel and the issues of the occupied territories and Palestinian self-determination. While basing its policy firmly on United Nations Security Council Resolution 242 -- which recognizes Israel's right to exist, calls for Israel to withdraw from occupied lands and urges a just settlement of refugee issues -- Tokyo strongly supports "the legitimate rights of the Palestinian people in accordance with the U.N. charter" and has adopted, self-admittedly, a pro-Arab position since 1973. Japan's voting record at the United Nations showed increasing independence from the Arab line in the 1980s, however; it either abstained from or voted against anti-Israeli resolutions with growing frequency. Initiatives by Tokyo in other areas also show that a policy reevaluation is taking place.

In 1977 Tokyo began fostering direct ties to the Palestine Liberation Organization by allowing it to open a representative office in Tokyo. Since then meetings between PLO and Japanese officials have been held sporadically, usually at the unofficial level. While steadily advocating self-determination for Palestinians and protesting Israeli treatment of Palestinians in the occupied territories, Tokyo also consistently has urged the PLO to recognize Israel's legitimate right of existence. Tokyo views mutual recognition of legitimacy by Israel and the Palestinians as a prerequisite to progress.

Foreign Minister Taro Nakayama's May 30-June 1 visit to Israel was a visible sign that Japan's emphasis on Arab and Palestinian relations is changing (see JEI Report No. 22B, June 14, 1991). Admittedly, Mr. Nakayama reiterated support for better Israeli treatment of Palestinians and an end to new Jewish settlements in occupied lands, and he urged Jerusalem to be pragmatic and flexible when considering U.S. proposals for a regional peace conference. But he also commented on another long-standing bilateral issue, the Arab trade boycott.

In response to the creation of the state of Israel in 1948 Arab nations organized a boycott against companies doing business with the Jewish nation. Although enforcement of the boycott has been flexible, Japanese companies have earned a reputation for stringent adherence. Major Japanese firms, such as Mitsubishi Motors Corp. and Fuji Heavy Industries, Ltd., are among those that have kept trade with Israel from fading away, but the boycott definitely has restrained activity. During his visit Mr. Nakayama directly attacked the boycott as an undesirable impediment to trade. He said, though, that Tokyo would not implement rules to punish firms that observe the boycott, a sanction the United States, Canada and some European nations have adopted.

Even though Tokyo has not changed its public stance on the boycott -- observance remains a decision for businesses to make based on commercial factors -- government officials apparently have been signaling privately that greater trade with the Jewish state is desirable. In April three Japanese automotive makers -- Toyota Motor Corp., Nissan Motor Co., Ltd. and Mazda Motor Corp. -- announced that they would begin direct exports of vehicles to Israel later this year. Mr. Nakayama sent a clear signal in favor of more bilateral trade when he responded positively to an Israeli request that the Export-Import Bank extend letters of credit for bilateral transactions, an unprecedented action in Japan-Israel relations. (The boycott issue may evaporate if the U.S.-sponsored peace process moves forward; Saudi Arabia, Egypt, Jordan, Bahrain, the United Arab Emirates, Qatar and Oman announced in late July that they would suspend the boycott if Israel halted new settlements in occupied lands.)

All of these steps, Tokyo hopes, will give it a bigger role in the recently revitalized Bush administration plan to hold a regional peace conference to address Arab-Israeli issues and the Palestinian problem. While the exact nature of this role is still evolving, it is not likely to be a pivotal one. Tokyo has demonstrated its willingness to use increased humanitarian and economic aid to the region as a carrot to encourage movement by both Israel and the Palestinians. Beyond this, however, Tokyo's leverage is uncertain. It is telling that Middle East countries have looked exclusively to the United States as the only nation that can forge a framework for peace. Tokyo may feel that cooperation and support for the U.S. plan is the best approach at this time. Should the American scheme fail, however, Tokyo may be encouraged to offer its own peace ideas.

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Iran - Iran's strategic location (occupying the north side of the Persian Gulf and extending out beyond the Strait of Hormuz), its relatively large economy and its abundant petroleum resources logically give it an important role in Japan's Middle East policy. Prior to 1979 the Shah of Iran's position as a staunch American ally also facilitated strong trade links with Japan. As seen in Table 5, Iran ranked high on Japan's list of trading partners in the region throughout the 1970s.

The 1979 Iranian revolution presented significant challenges to Tokyo. To maintain diplomatic and commercial ties to the new radical Islamic regime, Tokyo risked Washington's wrath by initially refusing to condemn the seizure of the U.S. Embassy and its staff by supporters of Ayatollah Khomeini. After it became public knowledge in Washington that Japanese firms not only were defying the U.S.-requested boycott of Iranian oil but were paying handsome prices for Iranian crude, Tokyo felt compelled to join its Western allies in applying limited economic sanctions against Iran. Once the hostage crisis was resolved, Tokyo quickly repaired ties to Iran by lifting its sanctions and restoring commercial activity, the centerpiece of which was a giant petrochemical facility at Bandar Khomeini.

Begun in 1971 while the shah ruled, the facility was a joint venture between the Iranian government and a consortium led by Mitsui & Co., Ltd. The importance both governments attached to the project became clear when the Iran-Iraq war broke out in late 1980. Tokyo urged Mitsui not to pull out of Iran-Japan Petrochemical Co. and to continue construction. (The plant was about 85 percent complete when the fighting started.) Despite sporadic bombing of the complex over the next eight years, IJPC refused to abandon the project. After a cease-fire was arranged in 1988, Mitsui decided that the plant no longer was economically viable, arguing that it was too heavily damaged and that its equipment was out-of-date. Tehran continued to insist that the work be completed. The project, which once symbolized Japanese-Iranian cooperation, became instead a source of bilateral friction.

It was not until early 1990 that a negotiated settlement was reached, allowing the Japanese consortium to withdraw from the joint venture in exchange for a Y130 billion (\$963 million at Y135=\$1.00) payment to the National Petrochemical Co., the Iranian partner (see JEI Report No. 18B, May 4, 1990). In late July Iran Chemical Development Co., Ltd., the Japanese consortium, received about Y76.5 billion (\$566.7 million) in partial reimbursement from the government's trade insurance fund but still faces debts of about Y72 billion (\$533.3 million). NPC has announced that it still plans to refurbish and complete the facility (now called Bandar Imam), perhaps with the help of individual Japanese firms.

As for efforts to resolve the Iran-Iraq war, Tokyo sought to use its diplomatic channels during the conflict to foster negotiations when both sides tired of the fighting. Although its role cannot be characterized as decisive, Tokyo certainly was in a better position than was Washington to act as a go-between -- a role it played even when Japanese tankers transiting the Persian Gulf were damaged by Iranian missiles and mines.

The taking of Americans as hostages in Lebanon in the mid-1980s again put Tokyo on the spot with Washington when the White House -- certain that Tehran was encouraging the abductions -- demanded in late 1987 that sanctions be

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imposed against Iran. Tokyo demurred, pointing to a lack of evidence of Tehran's complicity, including the Islamic regime's denial that it encouraged the kidnappings. This time, Tokyo deflected some U.S. ire by making sure that Japanese oil companies did not increase purchases from Iran. (Neither were contracts canceled, however.) Japan's open diplomatic lines to both Tehran and Washington, moreover, served as an important conduit for negotiations and helped ease tensions.

Japan slowly has rebuilt its commercial dealings with Iran since then, but two new issues threaten this progress. The Islamic regime inherited a large amount of American weaponry when it overthrew the shah, arms that were put to use against Iraq in their mutual war. An American investigation of sales of spare weapons parts to Iran led to the admission by Japan Aviation Electronics Industry, Ltd. this past July that it had repaired missile parts for and sold replacement aircraft parts to Iran near the end of the war with Iraq (see JEI Report No. 26B, July 12, 1991). Tokyo has pledged even tighter monitoring of trade with Iran, disappointing Tehran, which still has an American-stocked arsenal. Whether this incident will cool commercial activity remains to be seen.

Tokyo's handling of a potentially explosive incident illustrates the differences and similarities between Japanese and American attitudes on certain subjects. For example, the mid-July murder of the Japanese translator of The Satanic Verses, a book considered blasphemous by many Islamics, raised speculation immediately that there was a possible link to a 1989 death threat imposed by the late Ayatollah Khomeini (and later affirmed by Iranian rulers) against the book's author, Salman Rushdie. The Italian translator of the book had been seriously injured in an early July attack by an Iranian, prompting Japanese police authorities to seek help from foreign and international law enforcement agencies to explore a possible linkage between the two attacks.

Chief Cabinet Secretary Misoji Sakamoto called the murder unfortunate but added it was unlikely that a formal protest would be lodged with Iran. Rather than signaling deference to Tehran, however, Mr. Sakamoto explained the lack of action by characterizing the death threat as "too outrageous" to dignify with a protest. "In this age of freedom of thought and expression it is impermissible in the civilized world to issue a death sentence because one dislikes a work of literature," he argued. Such a strong statement would raise few eyebrows coming from the White House, but because it came from a top Liberal Democratic Party official it was taken as another sign of a more assertive Japanese policy.

Japan-Iran ties have survived many trials because both sides realize the links are mutually beneficial. As Tehran works to rebuild its war-ravaged economy and reassert its influence in regional politics, Japan will continue to be an important economic partner -- providing trade, investment and aid. But Tokyo also may become something of a mentor, helping Iran to return to the mainstream of international politics as part of Japan's long-standing goal of promoting stability in the region.

Other Issues - A recent international banking scandal could influence Japan's relations with the region. Offices of the Bank of Credit and Commerce International S.A., backed by the ruler of Abu Dhabi and linked to important figures in other Middle Eastern countries, were seized in early July by regulators in Great Britain, Luxembourg and the Cayman Islands after investigations

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and audits revealed major irregularities in the bank's worldwide operations. BCCI's Tokyo branch office voluntarily closed its doors days later at the request of the Ministry of Finance but then moved nearly all its deposits -- Y53.7 billion (\$397.8 million) worth as of March 31, 1991 -- out of Japan. MOF found that it had few legal options to prevent the transfer or control the activities of the foreign-based bank; it only lamely could ask a Tokyo court to freeze and then liquidate the branch's assets, reported to be Y83 billion (\$614.8 million) as of last March. Unlike BCCI's operations in other countries, however, the amounts involved in Japan are relatively small. Ishikawajima-Harima Heavy Industries Co., Ltd., the largest single depositor with the Tokyo BCCI branch (Y13.7 billion or \$101.5 million), is leading a depositor group in court proceedings to recover whatever assets remain in Japan.

While the financial impact may be insignificant, the political fallout may not be. The case is the first time a foreign bank has been liquidated in Japan and reveals a glaring hole in MOF's oversight powers. The ministry now is considering forcing foreign banks to join Japan's deposit insurance program and probably will draft legislation giving it the power to act independently and rapidly in situations similar to that created by BCCI. The affair has embarrassed both the powerful Finance Ministry and Sheikh Zayed bin Sultan al-Nahayan, the ruler of Abu Dhabi and BCCI's largest shareholder. Sheikh Zayed currently hopes to block international efforts to liquidate the bank and is offering to reorganize and recapitalize the institution. Because BCCI has a significant retail banking presence in many developing countries, depositors who can least afford it would suffer the most if BCCI were liquidated. Tokyo has yet to respond to the sheikh's reorganization plan but could turn embarrassment into benefit if it finds the plan worth supporting.

Rethinking Fundamentals

A strong current running through the Japanese debate over Middle East policy is a reevaluation of the region's importance to Japan. In terms of the monetary value of bilateral trade, it is clear that the Middle East is important but ranks well below North America or Asia as a destination for exports or as a source of imports. The region's role in Japan's energy picture remains significant, however, and likely will remain so well into the next century.

Despite this, Tokyo's domestic reaction to the embargo on trade with Iraq and Iraqi-occupied Kuwait almost was nonchalant. Armed with strategic oil reserves equivalent to many months of imports from the two countries as well as prearranged international cooperation to regulate energy supplies among oil-consuming nations and pledges to increase output by other oil-producing nations, Japanese government and business spokespersons reassured the public that any economic fallout from the Persian Gulf crisis would be minimal. Contrast this response to the public panics that swept the nation during the twin oil shocks of the 1970s and the efficacy of Japanese energy planning is obvious. Japan weathered the latest crisis so successfully that some wondered if Middle East oil truly was vital.

Because crude oil is a relatively fungible commodity (oil from one well generally can substitute for that from any other), some analysts have argued that the Middle East's importance to Japan's energy supply is overblown. As long as Middle East oil is available as a part of global supplies, it is unimportant where or from whom Japan buys its oil, runs the suggestion. This thinking led many Japanese at the time of Iraq's invasion of Kuwait to downplay the

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action's economic importance since oil from Kuwait's wells again would be sold on world markets once Iraqi leader Saddam Hussein digested his conquest. While this logic was correct from a purely business standpoint, it clashed head-on with Japan's new image as a global power willing to stand for principle and not just self-interest.

Equally important, the argument is based on the premise that Middle Eastern oil always will be available. The 1973-74 OPEC oil boycott and the mining of the Persian Gulf during the Iran-Iraq war show that this is not a defensible assumption. If the flow of oil from the region were shut off for any reason, the Middle East's importance to Japan and the rest of the world quickly would become apparent. While Tokyo will continue to pursue a greater role in the region's political jungle, oil-based trade will remain the *raison d'etre* of Japan-Middle East ties.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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